

Washington issues new regulations on software and digital products

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In brief

The Washington Department of Revenue released new regulations on the taxability of software and digital products. The two new regulations, WAC 458-20-15502 and -15503 were adopted February 25, 2013, and will become effective March 28, 2013. In addition, WAC 458-20-155 on Information and Computer Services has been repealed, and WAC 458-20-15501 has been amended. The Department issued the changes to clarify the impacts of previous legislation and to address other tax issues related to computer hardware, software, and computer services. Taxpayers engaged in selling software and digital products in Washington should review these regulations as they may provide clearer guidance for distinguishing between taxable and nontaxable digital goods, software, and services. [[Computer Hardware, Software, and Digital Products](#), Washington Department of Revenue, [WAC 458-20-155/15501/15502/15503](#)]

In detail

In 2009, Washington passed legislation imposing retail sales tax on digital products, including digital audio works, digital audio visual works, digital books, digital automated services, digital codes, and remote access software. Additional legislation passed in 2010 clarified ambiguities in the 2009 law.

On February 25, 2013, the Washington Department of Revenue issued new regulations to clarify the 2009 and 2010 legislation as well as give guidance related to sales of computer hardware, software, computer services, remote access software, and digital goods. The regulations were

adopted to update and further explain the application of the business and occupation (B&O) tax, retail sales tax, and use tax to persons providing these products and services.

WAC 458-20-15501 (Rule 15501) - Taxation of Computer Systems and Hardware is similar to its prior version, but has been truncated. It contains sections on taxation of computer systems; taxation of computer hardware, both internal and external peripheral devices; and taxation of other activities associated with computer hardware, as well as related examples.

WAC 458-20-15502 (Rule 15502) - Taxation of Computer Software adopts much of its

language from the previous version of Rule 15501. The regulation gives guidance on software related issues, including custom software, prewritten software, use of software licenses, royalties, and maintenance agreements. In addition to technical corrections, the regulation includes new sections on multiple points of use (MPU) and remote access software. Specific guidance and definitions are given regarding an exemption from retail sales tax for remote access prewritten computer software that is made available for free to the general public. Further, the regulation explains the taxability of software training charges combined with sales of

prewritten software, explaining that if a charge for software training is not separately stated from the sale of prewritten software, and the prewritten software value is more than de minimis, the entire charge is considered a retail sale subject to retailing B&O tax and the retail sales tax.

WAC 458-20-15503 (Rule 15503) - Digital Products is organized into six parts and is meant to function much like a decision tree. Each part addresses a question or topic relevant to the determination of whether a person is selling or purchasing a digital product or digital code, and, if so, what are the tax consequences that follow such activity. In general, the sale or use of digital products and digital codes is subject to the retail sales or use tax unless purchased for resale or if some other exemption applies. The common sales tax concept of bundled transactions is briefly mentioned in the miscellaneous section. However, rather than providing examples within the scope of digital products, the regulation cites existing sales tax statutes.

The six parts of the regulation are as follows:

Part 1: Are the products or services transferred electronically? If yes, go to Part 2.

Part 2: Does the product or service meet the general definitions of digital product or digital code? If yes, go to Part 3.

Part 3: Are there applicable exclusions from the general definitions of digital product or digital code? If no, go to Part 4.

Part 4: Are the sales of the digital product or digital code sourced to Washington? If yes, go to Part 5.

Part 5: Are there applicable retail sales or use tax exemptions for the purchase or use of the digital product or digital code? If no, the transaction is likely taxable in Washington.

Part 6: Miscellaneous provisions.

The takeaway

Although much of the language in the newly adopted regulations is similar to the previous versions, the regulations provide clearer guidance

for practitioners who wade through an often murky area of distinguishing between taxable and nontaxable digital goods, software and services.

One area still lacking clarity is the application of Washington's definition of 'digital automated service' to today's dynamic and complex business products, services, and subscription packages. An analysis of both the extent of human effort to provide the service (based on time and cost factors) and when the human effort originated may be required.

The new regulations help illustrate how taxpayers may benefit from the multiple points of use exemption. While the exemption on purchases of digital goods for business purposes has been around for a while and has been valuable for taxpayers, the exemption does not apply to other digital products and digital codes. The new regulations clarify the multiple points of use exemption, which applies to all digital products and digital codes used concurrently within and outside the state. The regulations provide examples of the MPU requirements, apportionment, and key definitions.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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